

BEFORE THE POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

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Statutory Review of the System for  
Regulating Rates and Classes for  
Market Dominant Products

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Docket No. RM2017-3

COMMENTS OF PITNEY BOWES INC.

James Pierce Myers  
Attorney at Law  
320 South West Street, Suite 110  
Alexandria, Virginia 22314  
Telephone: (703) 627-5112  
E-Mail: [jpm@piercemyers.com](mailto:jpm@piercemyers.com)

Michael F. Scanlon  
K&L GATES LLP  
1601 K Street, NW  
Washington, D.C. 20006  
Telephone: (202) 661-3764  
E-Mail: [michael.scanlon@klgates.com](mailto:michael.scanlon@klgates.com)

Counsel to PITNEY BOWES INC.

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Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments in response to Order No. 3673,<sup>1</sup> initiating the review of market dominant ratemaking system as required by the Postal Accountability and Enhancement Act (PAEA).<sup>2</sup>

## I. INTRODUCTION AND SUMMARY

The Postal Regulatory Commission (Commission) established the modern system of regulating rates and classes for market dominant products in Docket. No. RM2007-1, as required by the PAEA.<sup>3</sup> The PAEA grants the Commission the authority to review and revise by regulation the modern rate system and requires that the Commission undertake a review of the modern rate system 10 years after the date of enactment to determine whether the system it established is achieving the statutory objectives, taking into account the statutory factors, established by Congress.<sup>4</sup> If the Commission determines that the system it established is not achieving the statutory objectives then the Commission may by regulation make modifications or adopt an alternative system as necessary to achieve the objectives.<sup>5</sup> Order No. 3673 provides a framework to begin this review.

These comments focus on the issue of worksharing and conclude that changes are necessary to meet the statutory objectives. The PAEA requires the Commission to establish a modern rate system that is designed to “maximize incentives to reduce costs and increase efficiency”<sup>6</sup> and to “establish and maintain a just and reasonable schedule for rates.”<sup>7</sup> The PAEA further requires the Commission in establishing a modern rate system to consider: “the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect

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<sup>1</sup> Order No. 3673, Advance Notice of Proposed Rulemaking (ANPRM)(Dec. 20, 2016).

<sup>2</sup> See Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

<sup>3</sup> See 39 U.S.C. 3622(a).

<sup>4</sup> See 39 U.S.C. 3622(d)(3).

<sup>5</sup> See *id.*

<sup>6</sup> 39 U.S.C. 3622(b)(1).

<sup>7</sup> 39 U.S.C. 3622(b)(8).

upon reducing costs to the Postal Service,”<sup>8</sup> “the importance of pricing flexibility to encourage increased mail volume and operational efficiency,”<sup>9</sup> and “the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services.”<sup>10</sup>

The current workshare regulations are not achieving these statutory objectives taking into account the factors. First, inefficient workshare discounts fail to provide the maximum incentives to reduce costs and increase efficiency. Second, workshare discounts that fail to pass through the full value of the work performed by mailers and mail service providers are unjust and unreasonable because they are a form of unfair competition. As a result, setting workshare discounts below avoided costs has the effect of distorting competitive upstream postal markets by excluding more efficient private sector participants. Notwithstanding some recent improvements, the Postal Service’s practice of setting workshare discounts below avoided costs affects a substantial majority of commercial First-Class and Standard Mail, and consequently is an aspect of the modern rate system that merits reform through this review.

As applied to worksharing, Objectives 1 and 8 taking into account Factors 5, 7, and 12 can be met *only* by requiring by regulation a “soft floor” for workshare discounts. For purposes of these comments a “soft floor” means that by regulation workshare discounts would presumptively be set at, or as close as practicable to, avoided costs subject to clearly defined and limited exceptions similar to those already in place for the workshare “ceiling.”<sup>11</sup> A soft floor on workshare discounts will promote efficiency and the lowest combined total mailing system costs. A soft floor on workshare discounts will also promote fair competition in competitive upstream

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<sup>8</sup> 39 U.S.C. 3622(c)(5).

<sup>9</sup> 39 U.S.C. 3622(c)(7).

<sup>10</sup> 39 U.S.C. 3622(c)(12).

<sup>11</sup> 39 U.S.C. 3622(e).

postal processing and transportation markets by preventing the Postal Service from selling unbundled elements of its services below costs.

In its most recent report to Congress the Commission recommended “establishing a “soft floor” (a lower limit subject to certain exceptions) on workshare discounts” as a means of “benefit[ing] the postal community by providing appropriate price signals to incentivize efficient mail preparation.”<sup>12</sup> In making its recommendation, the Commission recognized that establishing a soft floor on workshare discounts would promote the efficiency objectives of the PAEA without unduly constraining the Postal Service’s pricing flexibility or negatively affecting any other statutory objective.

Establishing a soft floor on workshare discounts is sound policy, but the Commission need not look to Congress to make the change. The Commission can and should establish a soft floor for workshare discounts as part of the 10-year review. The Commission has the authority to require by regulation a soft floor on workshare discounts. The Commission’s worksharing regulations are squarely within the scope of the 10-year review and establishing a soft floor on workshare discounts is a reasonable construction of the PAEA because it is the only interpretation that best gives effect to multiple statutory objectives (Objectives 1 and 8) and factors (Factors 5, 7, and 12) without unduly conflicting with any others. By applying a soft floor to workshare discounts, then, the Commission can eliminate the current failure in the system to provide the appropriate economic incentives and will prevent distortion in the upstream postal markets.

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<sup>12</sup> Section 701 Report Analysis of Postal Accountability and Enhancement Act of 2006 (Section 701 Report)(Nov. 14, 2016) at 11.

## II. DISCUSSION

### A. The History and Importance of Worksharing

For over 40 years, the Postal Service has engaged in an innovative public-private partnership called worksharing. The Postal Service offers discounted postage to mailers if they perform certain activities that reduce the Postal Service's costs, including: presortation (by Zip Code and carrier walk sequence), barcoding, and transporting the mail to Postal Service facilities closer to the final delivery destination.

Prior to the enactment of PAEA, the Commission generally required that workshare discounts be set equal to the costs avoided by the Postal Service.<sup>13</sup> In regulatory economics, this pricing principle is referred to as Efficient Component Pricing Rule (ECPR). As the name suggests, under ECPR, access prices for the individual components of a service promote the most efficient use of each component.<sup>14</sup> In the case of worksharing, each discount is effectively the price for a processing or transportation step in the Postal Service's network, from mail induction through ultimate delivery. If a mailer wants to purchase the step from the Postal Service, it pays the full undiscounted price. If not, the mailer performs the work itself and pays the lower, discounted price. From the perspective of the Postal Service, ECPR-based worksharing prices

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<sup>13</sup> See e.g., Docket No. R2006-1, Op. and Rec. Decision (Feb. 26, 2007), at ¶ 4005 ("Since [Docket No. MC95-1], broad support has grown for applying [efficient component pricing (ECP)] in the development of mail processing workshare rates. Indeed, in every subclass that has worksharing discount rates, both the Postal Service and the Commission strive to obtain an ECP outcome, i.e., a one-hundred percent passthrough of the avoidable cost savings.") and ¶ 4027 ("In this recommended decision, the Commission has used ECP to design rates in those subclasses that contain mostly pieces over which the Postal Service has a market dominant position. *This should produce fair rates that promote economic efficiency.*") (emphasis added); Docket No. MC95-1, Op. and Rec. Decision (Jan. 26, 1996), at ¶ 4256 ("In order to send a signal to producers that will ensure that competitive components of postal services (worksharing discounts) are produced at the least cost to society, the efficient component pricing rule prescribes that their rates be set equal to the monopolist's marginal cost (or average incremental cost) for producing that component.").

<sup>14</sup> See R. Cohen, M. Robinson, J. Waller, and S. Xenakis (2006), "Worksharing: How Much Productive Efficiency, at What Cost and at What Price?" in *Progress Toward Liberalization of the Postal and Delivery Sector* (Springer), edited by M. Crew and P. Kleindorfer, at 2 (established policy of Postal Rate Commission to use workshare discounts to ensure access to the delivery network of the Postal Service and to promote productive efficiency of monopoly letter mail industry).

encourage efficient “make or buy” decisions in setting access prices to the Postal Service’s network; mailers or mail service providers will choose to perform a particular workshare activity *if and only if* the mailer’s cost is less than the discount offered, making it profitable for the mailer to perform the work.<sup>15</sup>

Because mailers will choose to do the work themselves only when it is cheaper for them to do so and allows the Postal Service to do the work when that is the less expensive alternative, worksharing discounts that satisfy ECPR ensure that postal products are produced at the lowest possible combined cost. The savings to mailers – e.g., when a mailer can qualify for a 10 cent discount by performing work that costs it only nine cents to do – will minimize total cost to mail which will stimulate volume growth.<sup>16</sup> The case for ECPR as a means to promote efficiency and fairness in postal access pricing is well documented in postal economic literature<sup>17</sup> and in testimony before the Commission.<sup>18</sup>

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<sup>15</sup> See Dkt. No. RM2017-3, Statement of John C. Panzar on Behalf of Pitney Bowes Inc. (Panzar Statement)(Mar. 20, 2017) at 305.

<sup>16</sup> See e.g., E. Pearsall (2005), “The Effects of Worksharing and Other Product Innovations on U.S. Postal Volumes and Revenues” in *Regulatory and Economic Challenges in the Postal and Delivery Sector* (Kluwer), edited by M. Crew and P. Kleindorfer.

<sup>17</sup> See e.g., Cohen, Robinson, Waller, and Xenakis (2006); J. Haldi and W. Olson (2003), “An Evaluation of USPS Worksharing: Postal Revenues and Costs From Workshared Activities,” in *Competitive Transformation of the Postal and Delivery Sector*, (Kluwer) edited by M. Crew and P. Kleindorfer; R. Mitchell (1999), “Postal Worksharing: Technical Efficiency and Pareto Optimality,” in *Emerging Competition In Postal and Delivery Services* (Kluwer), edited by M. Crew and P. Kleindorfer.

<sup>18</sup> Dr. John Panzar has provided a detailed theoretical analysis of Efficient Component Pricing (“ECP”), the principle that work-sharing discounts should be set equal to the per unit avoided costs of the Postal Service on numerous occasions. See, e.g., Docket No. R2006-1, Direct Testimony of John C. Panzar on behalf of Pitney Bowes Inc., PB-T-1 (Revised), (Oct. 31, 2006) at 16-24 (ECPR-based worksharing discounts in postal ratemaking should be set equal to the per unit avoided costs of the Postal Service); Docket No. RM2007-1, Initial Comments of John C. Panzar on behalf of Pitney Bowes Inc. In Response to Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking (Apr. 6, 2007) at 7-12 (setting workshare discounts equal to the per unit avoided costs of the Postal Service will minimize the total costs and increase the overall productive efficiency of the postal sector by inducing mailers and mail service providers to choose to perform workshare functions if and only if they can perform the work at a lower cost than the Postal Service; setting workshare discounts at less than the per unit avoided costs of the Postal Service will exclude some equally efficient or more efficient mailers or mail service providers from performing workshare functions.); Docket No. ACR2011, Comments of John C. Panzar Submitted on behalf of Pitney Bowes, at 1, 5 (Feb. 3, 2012)(“Worksharing discounts below avoided costs exclude efficient competitors in the upstream mail processing market from access to the monopoly delivery network of the Postal Service.”. . . “Deviating from [efficient component pricing] reduces productive efficiency and raises serious competition policy concerns.”).

Beyond the theoretical justifications, using workshare discounts to send efficient and correct price signals is critically important because worksharing affects a substantial portion of Postal Service mail volume and revenue. Workshare pricing affects all major mail classes. Table 1 and Table 2, following, for example, show mail volumes and Postal Service revenues for Automation Letters in First-Class and Standard Mail over the last nine years.

Table 1. First-Class Mail Automation Letters Volume & Revenue (000s)

		<b>Volume</b>	<b>Revenue</b>
FY 2016	[1]	36,885,382	\$14,518,832
FY 2015	[2]	37,060,873	\$14,625,921
FY 2014	[3]	37,016,391	\$14,265,739
FY 2013	[4]	37,870,590	\$13,989,612
FY 2012	[5]	39,244,371	\$14,139,411
FY 2011	[6]	40,742,952	\$14,296,318
FY 2010	[7]	42,130,624	\$14,652,635
FY 2009	[8]	43,522,082	\$14,852,014
FY 2008	[9]	46,849,718	\$15,476,092

Source: See endnotes "Table 1: Sources"

Table 2. Standard Mail Automation Letters Volume & Revenue (000s)

		<b>Volume</b>	<b>Revenue</b>
FY 2016	[1]	47,793,778	\$9,878,477
FY 2015	[2]	46,549,187	\$9,743,940
FY 2014	[3]	46,270,477	\$9,512,065
FY 2013	[4]	45,304,259	\$8,968,900
FY 2012	[5]	44,625,242	\$8,681,126
FY 2011	[6]	48,850,146	\$9,367,524
FY 2010	[7]	46,332,496	\$8,810,552
FY 2009	[8]	44,207,763	\$8,289,746
FY 2008	[9]	54,117,693	\$9,947,374

Source: See endnotes "Table 2: Sources"

Today more than 83 percent of all market dominant mail volume is subject to some form of worksharing.<sup>19</sup>

## B. Congressional Support for Worksharing Under PAEA

Congress recognized the importance of worksharing when it enacted the PAEA.<sup>20</sup> The PAEA included, for the first time, a statutory definition of workshare discounts and required the Commission to establish rules and specific reporting requirements for workshare discounts as part of a modern system for regulating rates.<sup>21</sup> Consistent with the PAEA's goal of promoting efficiency and fairness, numerous statutory objectives and factors directly relate to workshare pricing. The first statutory objective directs the Commission to design a system "to maximize incentives to reduce costs and increase efficiency"<sup>22</sup> (Objective 1). Another statutory objective directs the Commission to establish a "just and reasonable schedule for rates and classifications"<sup>23</sup> (Objective 8).

The PAEA expressly requires the Commission to take account of "the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service"<sup>24</sup> (Factor 5). The PAEA also requires that the Commission consider the "importance of pricing flexibility to encourage increased mail volume

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<sup>19</sup> Derived as the sum of all Standard Mail, Periodicals, and First Class Presort Letters divided by the total of Market Dominant Volumes for FY 2016.

<sup>20</sup> The importance of workshare pricing as a policy tool to drive efficiency and promote fair competition in competitive, upstream postal markets was well established at the time Congress was considering postal reform legislation that would become the PAEA. For example, a General Accounting Office "Primer on Postal Worksharing," (July 2003), noted the Commission's guideline for recommending worksharing discounts that "the estimated reduction in USPS revenues will equal the estimated reduction in USPS costs," resulting in a 100 percent pass through of the expected USPS savings to the mailer. Primer, at 33. The GAO further noted that "[w]orksharing discounts with 100 percent pass through create an incentive for the lowest-cost provider to do the work," and cautioned that if the discounts are less than 100 percent "some lowest-cost providers may not have an incentive to workshare." *Id.* See also *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, Report of the President's Commission on the United States Postal Service, (Jul. 31, 2003), at 87 ("The Postal Service should focus on its core competency - delivering the mail. Where private companies can deliver portions of the nation's postal service or specific related functions better and at lower cost, those tasks should be outsourced.").

<sup>21</sup> 39 U.S.C. 3622(e).

<sup>22</sup> 39 U.S.C. 3622(b)(1).

<sup>23</sup> 39 U.S.C. 3622(b)(8).

<sup>24</sup> 39 U.S.C. 3622(c)(5).

and operational efficiency”<sup>25</sup> (Factor 7), and the “need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postage rates”<sup>26</sup> (Factor 12).

### C. Workshare Regulations Under the Modern Rate System

Many parties asked that the Commission adopt its longstanding regulatory practice of requiring discounts to comply with ECPR when the Commission was establishing the modern rate system in 2007.<sup>27</sup> In its Order establishing the modern rate system, the Commission stated that ECPR should serve as a “guiding principle,”<sup>28</sup> but it declined to require by regulation that workshare discounts be set equal to avoided costs.

It was difficult to predict at the time how the workshare pricing would evolve under the modern rate system, but with the benefit of 10-years’ experience, it is now clear that the worksharing regulations established by the Commission do not maximize incentives to reduce costs and increase efficiency as required by Objective 1, do not promote fair competition in upstream mail processing and transportation markets as required by Objective 8, and do not adequately take account of the statutory Factors 5, 7, and 12.

With the benefit of this experience, the Commission has acknowledged that workshare discounts that fail to reflect the full value of the avoided costs are inconsistent with the statutory objectives and factors:

Although the requirements of the PAEA do not directly address workshare discounts that are below 100 percent of avoidable costs, the first objective in 39 U.S.C. § 3622(b) is “[t]o maximize incentives to reduce costs and increase efficiency.” Passthroughs below 100 percent typically indicate inefficiencies.

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<sup>25</sup> 39 U.S.C. 3622(c)(7).

<sup>26</sup> 39 U.S.C. 3622(c)(12).

<sup>27</sup> See Docket No. RM2007-1, Comments of Pitney Bowes Inc. (Apr. 6, 2007) at 28; Comments of Alliance of Nonprofit Mailers, National Association of Presort Mailers, and National Postal Policy Council (Apr. 6, 2007) at 20; Comments of Valpak Direct Marketing Systems, Inc. and Valpak Dealers Association, Inc. (Apr. 6, 2007) at 11.

<sup>28</sup> Docket No. RM2007-1, Order No. 43 (Oct. 29, 2007) at 41.

The Postal Service should examine such potential inefficiencies and work to set rates which more fully reflect efficient component pricing.”<sup>29</sup>

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While the PAEA does not impose a minimum passthrough of avoided costs for workshare discounts, parts of the PAEA (including section 3622(b)(1) on incentives to increase efficiency and section 3622(c)(5) on reflecting the degree of mail preparation) do provide a rationale for promoting efficient mailing choices by mailers. Setting workshare discounts as close as feasible to 100 percent of avoided costs helps to promote these goals.<sup>30</sup>

As further acknowledgement of the need for change, in its most recent Section 701 Report to Congress the Commission recommended that Congress “establish[] a “soft floor” (a lower limit subject to certain exceptions) on workshare discounts” as a means of “benefit[ing] the postal community by providing appropriate price signals to incentivize efficient mail preparation.”<sup>31</sup> The Commission further noted that the establishment of a soft floor would be an effective means of balancing the Postal Service’s concerns about pricing flexibility with the statutory goal of increased efficiency.<sup>32</sup>

Establishing a soft floor for workshare discounts would be a significant improvement to the current system. The Commission has the authority to require *by regulation* a soft floor for workshare discounts as part of its review mandated by section 3622(d)(3). It need not wait for Congress to act. The Commission can and should establish by regulation a soft floor for workshare discounts as part of the 10-year review.

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<sup>29</sup> Docket No. ACR2007, Annual Compliance Determination (Mar. 27, 2008) at 97.

<sup>30</sup> Docket No. ACR2009, Annual Compliance Determination (Mar. 29, 2010) at 73.

<sup>31</sup> 701 Report 2016 at 11, Appdx. A, p.1.

<sup>32</sup> See 701 Report at 10.

D. The Statutory Objectives and Factors that Directly Relate to Workshare Pricing can Be Met *Only* by Requiring that Workshare Discounts Be Set Equal to, or as Close as Practicable to, Avoided Costs

As applied to worksharing, the PAEA directs the Commission to establish a modern rate system that is designed to maximize incentives to reduce costs and improve efficiency (Objective 1), to ensure just and reasonable rates (Objective 8), and to take into account the degree of preparation of mail and the effect on costs (Factor 5), the importance of pricing flexibility to encourage mail volume growth and operational efficiency (Factor 7), and the need for increased efficiency and reduced costs, as a means of maintaining high-quality, affordable postage rates (Factor 12). These statutory objectives and factors can *only* be met by establishing a soft floor on workshare discounts.

1. Objective 1: Maximizing Incentives to Reduce Costs and Increase Efficiency

The first statutory objective requires the Commission to design a modern rate system to “maximize incentives to reduce costs and increase efficiency.”<sup>33</sup> In Order No. 3673 the Commission defines Objective 1, as it applies to worksharing, as follows: “using workshare discounts, to the fullest extent possible to incentivize the reduction of costs and increases in operational and pricing efficiency.” ANPRM at 4. This is a fair and reasonable definition. The Commission also identifies three measurable key concepts: “(1) maximize incentives, (2) reduce costs, and (3) increase efficiency.” *Id.* Unfortunately, the current workshare regulations do not satisfy any of the three measurable key concepts.

A “review of whether workshare discounts provided the maximum incentives possible,” *id.*, confirms that the current system is not achieving Objective 1. For example, the Postal Service has persistently set workshare discounts below avoided costs at the 5-Digit Automation

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<sup>33</sup> 39 U.S.C. 3622(b)(1).

Level for letters (as shown in Tables 3 and 4 below) since the implementation of the PAEA, and thus, below the maximum incentive possible; a practice that affects a substantial quantity of mail.

Table 3. First-Class Mail 5-Digit Automation Letters

Fiscal Year		Cost Avoided	Discount	Passthrough
		[1]	[2]	[3]
2016	[a]	3.40	2.30	67.6%
2015	[b]	3.60	2.50	69.4%
2014	[c]	3.10	2.50	80.6%
2013	[d]	2.90	2.40	82.8%
2012	[e]	2.50	2.40	96.0%
2011	[f]	2.50	2.50	100.0%
2010	[g]	2.60	2.20	84.6%
2009	[h]	2.60	2.20	84.6%
2008	[i]	2.43	2.20	90.4%

Source: See endnotes "Table 3: Sources"

Table 4. Standard Mail 5 Digit Automation Letters

Fiscal Year		Cost Avoided	Discount	Passthrough
		[1]	[2]	[3]
2016	[a]	2.60	1.90	73.1%
2015	[b]	2.60	1.70	65.4%
2014	[c]	2.20	1.80	81.8%
2013	[d]	2.00	1.90	95.0%
2012	[e]	2.00	1.80	90.0%
2011	[f]	1.90	1.80	94.7%
2010	[g]	2.00	1.80	90.0%
2009	[h]	1.97	1.80	91.3%
2008	[i]	1.80	1.60	89.1%

Source: See endnotes "Table 4: Sources"

As a result, workshare prices have not “maximize[d] incentives,” have not “reduce[d] costs” by minimizing the total system costs of the postal system which would, in turn, have reduced the attributable cost per piece, and have not “increase[d] efficiency” as they otherwise could have. The ANPRM further states that a “comparison of actual prices and prices that adhere to principles of efficiency component pricing” could also be used to highlight whether the prices maximized incentives to increase productive efficiency and, thus, overall efficiency.

ANPRM at 4. Tables 3 and 4 also clearly show that prices for 5-Digit Automation Letters in First-Class and Standard Mail do not maximize productive efficiency and, thus, do not achieve Objective 1.

Further, the Commission has acknowledged that under the current system, the Postal Service's practice of setting workshare discounts below avoided costs has failed to achieve Objective 1:

Although the requirements of the PAEA do not directly address workshare discounts that are below 100 percent of avoidable costs, the first objective in 39 U.S.C. § 3622(b) is “[t]o maximize incentives to reduce costs and increase efficiency.” Passthroughs below 100 percent typically indicate inefficiencies. The Postal Service should examine such potential inefficiencies and work to set rates which more fully reflect efficient component pricing.”<sup>34</sup>

A strict ECPR requirement would maximize Objective 1, but the Commission appropriately recognizes that the PAEA requires it to apply Objective 1 “in conjunction with the others.”<sup>35</sup> Accordingly, the Commission has advocated in support of requiring a soft floor, subject to clearly defined and limited exceptions, as a compromise. A soft floor for workshare discounts would maximize the efficiency objectives of Objective 1 while balancing other objectives.

Establishing a soft floor also gives effect to the statutory factors that relate to worksharing. Factor 5 requires the Commission to take account of “the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service.”<sup>36</sup> A soft floor for worksharing discounts would ensure that mailers and mail service providers were fully compensated for the work they perform (degree of mail preparation) that avoids costs for the Postal Service. A soft floor would also give effect to Factor

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<sup>34</sup> Docket No. ACR2007, Annual Compliance Determination (Mar. 27, 2008) at 97.

<sup>35</sup> 39 U.S.C. 3622(b).

<sup>36</sup> 39 U.S.C. 3622(c)(5).

7 (“importance of pricing flexibility to encourage increased mail volume and operational efficiency”<sup>37</sup>) and Factor 12 (the “need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postage rates”<sup>38</sup>) because more efficient pricing signals will help grow mail volume and reduce costs, including infrastructure costs.<sup>39</sup>

Because the modern rate system regulations do not require the Postal Service to set workshare discounts equal to, or as close as practicable to, avoided costs, the current system does not achieve Objective 1 and the related statutory factors. Establishing a soft floor on workshare discounts, as opposed to a strict ECPR requirement, would help achieve Objective 1 while balancing the Postal Service’s concerns regarding pricing flexibility and other statutory objectives.

## 2. Objective 8: Just and Reasonable Schedule of Rates

Relevant for purposes of workshare pricing, Objective 8 requires the Commission to “establish and maintain a just and reasonable schedule of rates.”<sup>40</sup> In Order No. 3673 the Commission defines Objective 8 to “require[] that rates . . . are linked to distinct cost or market characteristics, and the amount charged for each service is neither excessive to the mailer nor threatens the financial integrity of the Postal Service.” ANPRM at 9. This definition is reasonable and appropriately reflects the concern in the PAEA with preventing the Postal Service from abusing its monopoly status with respect to market dominant products.

Although the preliminary definition offered by the Commission is primarily geared to assessing the absolute rate levels charged by the Postal Service, the Commission states that a

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<sup>37</sup> 39 U.S.C. 3622(c)(7).

<sup>38</sup> 39 U.S.C. 3622(c)(12).

<sup>39</sup> See Panzar Statement at 6.

<sup>40</sup> 39 U.S.C. 3622(b)(8).

“review of price and cost relationships could also be conducted to ensure that customers are protected from misuse of the Postal Service’s monopoly power.” *Id.* As applied to workshare pricing, the concern is whether workshare discounts, as a form of access pricing, have the effect of excluding more efficient mailers and mail service providers from competitive upstream services (presorting, prebarcoding, handling, and transportation of mail). The existing workshare regulations have not achieved Objective 8.

Under the current system the Postal Service is permitted to set key workshare discounts below avoided costs and regularly does so. Setting workshare discounts below avoided costs is inefficient and intuitively unfair. For example, suppose that presorting saves the Postal Service 10 cents, that USPS only offers an eight-cent presort discount, and that a mail service provider can perform the work for nine cents. In this case, the mailer would not hire the mail service provider to presort the mail even though it can perform the work more efficiently than the Postal Service.

Setting workshare discounts below avoided is also unfair and unreasonable because it is a form of exclusionary or anticompetitive pricing:

Worksharing discounts less than avoided costs are exclusionary. They prevent equally efficient competitors from participating in the market for upstream mail processing. For this reason, an ECP based access pricing ceiling (worksharing discount floor) should be a part of any modern system for regulating rates.<sup>41</sup>

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<sup>41</sup> Docket No. ACR2011, Comments of John C. Panzar on behalf of Pitney Bowes Inc. (Feb. 3, 2012), at 17 (discussing the need to augment price cap regulation with access pricing regulations to protect against anticompetitive vertical price squeeze)(citing Ingo Vogelsang, *Journal of Economic Literature*, Vol. XLI (Sept. 2003) at 842; Jean-Jacques Laffont and Jean Tirole: “Access Pricing and Competition,” *European Economic Review*, 38, pp. 1673-1710. (1994); “Creating Competition through Interconnection: Theory and Practice,” *Journal of Regulatory Economics* 10, pp. 227-56 (1996); and *Competition in Telecommunications*, Cambridge, MA: MIT Press (2000)).

Exclusionary pricing is unjust and unreasonable.<sup>42</sup> Because the current workshare regulations do not protect against exclusionary pricing in upstream competitive postal markets the current system has not achieved Objective 8.

Again, a strict ECPR requirement would maximize Objective 8, but the PAEA requires the Commission to apply Objective 8 “in conjunction with the others.”<sup>43</sup> Accordingly, the Commission has advocated in support of requiring a soft floor, subject to clearly defined and limited exceptions, as a compromise. A soft floor for workshare discounts would achieve the objectives of Objective 8, while balancing other objectives.

E. Establishing a Soft Floor Would Give Effect to the Statutory Objectives and Factors that Directly Relate to Workshare Pricing Without Impairing Any Other Objective

There are many statutory objectives and factors and the PAEA requires that they all “shall be applied in conjunction with the others.”<sup>44</sup> Establishing a soft floor for workshare discounts, with clearly defined and limited exceptions, would help achieve multiple statutory objectives and factors without unduly conflicting with or affecting the others.

1. Creating Predictability and Stability in Rates (Objective 2)

The Commission’s preliminary definition states that a system achieving Objective 2 “fosters rates, including prices for all market dominant products and promotions, that are capable of being consistently forecast with regard to timing and magnitude and that do not include sudden or extreme fluctuations.” ANPRM at 5. The CPI-based price cap is the primary statutory mechanism for achieving predictability and stability in rates. Establishing a soft floor for

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<sup>42</sup> Because the Postal Service is statutorily immune from the antitrust laws with respect to market dominant products covered by the private express statutes, *see* 39 U.S.C. § 409(e), only the Commission can act to ensure fair competition in these upstream competitive markets.

<sup>43</sup> 39 U.S.C. 3622(b).

<sup>44</sup> 39 U.S.C. 3622(b).

workshare discounts would not affect the price cap and could help promote rate stability and predictability for workshared products.

A soft floor on workshare discounts would ensure that workshare prices reflected Commission-approved cost models, as opposed to other less predictable rate design considerations. Increased stability would stimulate investment in the mail by mailers and mail service providers because they could predict with greater certainty how workshare prices would reflect the value of the work that they perform. To the extent changes in the cost models introduced rate volatility, a soft floor would allow changes to be managed via an exception process to mitigate rate shock, just as they are today with respect to the workshare ceiling.

## 2. Maintaining High Quality Service Standards (Objective 3)

The Commission's preliminary definition states that a system achieving Objective 3 is "designed for the Postal Service to consistently achieve, for each class of mail, stated days to delivery at a desired target rate." ANPRM at 5. Establishing a soft floor for workshare discounts would not interfere with the Postal Service's ability to meet the service standards established under 39 U.S.C. 3691. In fact, by requiring the Postal Service to fully compensate mailers and mail service providers for upstream activities that save the Postal Service costs, a soft floor for workshare discounts would provide additional incentive for all parties to maximize the quality of those services. For example, in First-Class Mail Letters, efficient workshare prices would provide added incentive for mailers to help the Postal Service meet service standards by encouraging mailers to convert mail that they would otherwise enter as AADC Letters into trays or pallets of 5-Digit Automation Letters, reducing the number of processing steps and the associated time required to sort these pieces into delivery point sequence.

### 3. Allowing for Postal Service Pricing Flexibility (Objective 4)

The Commission’s preliminary definition states that a system achieving Objective 4 “allows for the Postal Service to exercise its discretion to set prices, the price structure, and the price schedule for market dominant products, subject to other requirements under the law.”

ANPRM at 6. The PAEA promotes expanded pricing flexibility across two important dimensions: procedural and substantive pricing flexibility. A soft floor on workshare discounts does not interfere with procedural pricing flexibility and does not meaningfully constrain substantive pricing flexibility.

The PAEA affords the Postal Service increased procedural pricing flexibility through the elimination of the requirement for an advance, on-the-record Commission review and approval of price adjustments, through the possibility of more frequent price adjustments, and a minimal “quick look” compliance review upon filing a price adjustment.<sup>45</sup> A soft floor on workshare discounts would have no effect on procedural pricing flexibility.

A soft floor on workshare discounts would not interfere with the Postal Service’s flexibility to set different prices for different products, which is the core of the substantive pricing flexibility afforded under the PAEA. For example, in First-Class Mail a soft floor would only constrain price relationships between presort tiers of a particular product, it would not constrain the Postal Service’s ability to set different price relationships between different products (e.g., Presort Letters, Single-Piece Cards, Flats, or Packages). The same is true for all other classes of mail. The Postal Service would also retain its pricing flexibility to establish non-workshare policy-based pricing differentials (e.g., FSIMb discounts or the Metered Letters Rate) to drive efficiency, reduce costs, or segment its customer base.

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<sup>45</sup> See 39 U.S.C. 3622(d).

The tension among the conflicting objectives of efficiency, fairness, and flexibility can be reconciled by reading Objective 4 in concert with the statutory pricing flexibility factor (Factor 7). That factor states that the Commission in establishing or revising the modern rate system must take account of “the importance of pricing flexibility to encourage increased mail volume and operational efficiency.”<sup>46</sup> Read in context with the relevant factor, it is clear that the PAEA was not promoting pricing flexibility as a good in and of itself, but rather as a means of encouraging increased mail volume and operational efficiency.

A soft floor on workshare discounts would not meaningfully limit pricing flexibility to increase mail volume because it only constrains price difference between workshare variants of the same product. Because price elasticities presumptively differ more between products than between presort tiers within products, the pricing flexibility that matters most to drive mail volumes is inter-product pricing flexibility - increasing prices less on more elastic products (e.g., Standard Mail Carrier Route products related to Standard Mail Non-Carrier Route products) should help drive mail volumes. In general, setting workshare discounts below avoided costs would only promote increased mail volume when, for example, the price elasticity of the non-workshare category is higher than the workshare category. The Postal Service does not have price elasticity estimates by presort level. However, because there are good reasons to believe that the elasticity estimates would be similar within a product, there is no reason to believe that a soft floor would have any negative effect on mail volumes within presort. If anything, by promoting efficiency and the lowest combined total system costs, a soft floor would likely help stimulate mail volume growth among workshare products.

As to operational efficiency, a soft floor on workshare discounts would, by design, promote productive efficiency by incentivizing the least cost provider to perform the work.

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<sup>46</sup> 39 U.S.C. 3622(c)(7).

The Commission squarely addressed the issue of balancing the PAEA’s efficiency and fairness goals with the Postal Service’s pricing flexibility concerns in the context of worksharing in its most recent Section 701 Report to Congress. The Commission stated:

As for worksharing, the Commission recognizes that establishing a “soft floor” (a lower limit subject to certain exceptions) on worksharing discounts may eliminate inefficiencies caused by the Postal Service performing work that mailers may perform at a lower cost. . . . , the Commission notes that the Postal Service’s concerns about pricing flexibility may be balanced with the goal of increased efficiency by allowing limited statutory exceptions to the soft floor requirement. These statutory exceptions would be modeled on the exceptions that currently exist for the worksharing discount “soft ceiling” (an upper limit subject to certain exceptions).<sup>47</sup>

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With clearly defined and limited exceptions similar to those already in place for the workshare discount ceiling, the Commission notes that establishing a soft floor would be an enhancement to the PAEA that would benefit the postal community by providing appropriate pricing signals to incentivize efficient mail preparation.<sup>48</sup>

In its Section 701 Report to Congress the Commission recommended that Congress establish a soft floor on workshare discounts, but the analysis regarding the balancing of interests between the PAEA’s efficiency, fairness, and pricing flexibility goals is the same whether the requirement is imposed by statute or by regulation.

The Postal Service objected to the Commission’s recommendation in the Section 701 Report on the grounds that the establishment of a soft floor on workshare discounts would

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<sup>47</sup> Clearly defined and limited exceptions to the “soft floor” similar to those already in place for the workshare discount ceiling would be appropriate: (1) for a new postal service or new workshare discount if “necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service,” *see* 39 U.S.C. 3622(e)(2)(A)(i-ii), (2) if “necessary to mitigate rate shock,” *see* 39 U.S.C. 3622(e)(2)(B), (3) if increasing an existing workshare discount would “impede the efficient operation of the Postal Service,” *see* 39 U.S.C. 3622(e)(2)(D), and (4) if increasing the existing discount would “lead to a loss of volume in the affected category” and “reduce the aggregate contribution to institutional costs of the Postal Service” from the affected category, *see* 39 U.S.C. 3622(e)(3)(A).

<sup>48</sup> Section 701 Report at 10-11.

amount to a “mechanistic requirement” that would “dramatically reduce” its pricing flexibility.<sup>49</sup> This response misreads the Commission’s recommendation. The soft floor on workshare discounts would operate as a presumption, not an absolute constraint. Clearly defined, limited exceptions to the soft floor would allow deviations from 100 percent passthroughs where the Postal Service could prove that ECP prices would negatively affect efficiency, mail volume or contribution. To the extent the benefits of reducing costs, promoting productive efficiency, and stimulating new mail volume growth were not enough, establishing by regulation a soft floor on workshare discounts would not affect the Postal Service’s procedural pricing flexibility and would not affect the substantive pricing flexibility that matters most.

#### 4. Assuring Adequate Revenues (Objective 5)

For similar reasons, a soft floor on workshare discounts will not impair the ability of the Postal Service to achieve Objective 5. The Commission’s preliminary definition states that a system achieving Objective 5 assures “the Postal Service is financially solvent while able to respond to changes in its environment (e.g., volume erosion, legal or regulatory framework, demographic trends) and meet its statutory obligations (e.g., pricing and universal service).” ANPRM at 7. Under a price cap system, the amount of revenue generated by the Postal Service is unaffected by the size of the workshare discount under the usual constant mail mix assumption. Workshare discounts set equal to costs avoided are, by design, contribution neutral; volume shifts (e.g., from less-workshared to more-workshared rates) do not affect contribution because the change in revenue is equal to the corresponding cost avoidance. As discussed above, by promoting efficiency and the lowest combined total system costs, a soft floor would likely help stimulate mail volume growth among workshare products.

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<sup>49</sup> Postal Service Response to Section 701 Report at 11.

5. Reducing the Administrative Burden of the Ratemaking Process (Objective 6)

The Commission’s preliminary definition states that a system achieving Objective 6 “balances the (sometimes competing) concepts of reducing the costs imposed by rate proceedings or regulatory requirements generated by those proceedings, and the availability of comprehensive understandable material relating to each rate proceeding.” ANPRM at 8. Establishing a soft floor for workshare discounts would not affect this objective; the Postal Service’s workshare reporting obligations would remain essentially unchanged because it is already required to provide workshare discount and cost avoidance estimates.

6. Enhancing Mail Security and Deterring Terrorism (Objective 7)

The Commission’s preliminary definition states that a system achieving Objective 7 “encourages methods of safeguarding the mail system from illegal or dangerous use, or terrorism.” ANPRM at 9. Establishing a soft floor on workshare discounts would not affect this objective.

7. Allocating Institutional Costs (Objective 9)

The Commission’s preliminary definition states that a system achieving Objective 9 “has a mechanism to appropriately divide total institutional costs between market dominant and competitive products in a manner reflecting the relevant statutory considerations.” ANPRM at 10. Establishing a soft floor on workshare discounts would not affect this objective because establishing a soft floor on workshare discounts would not affect the pool of institutional costs or the methodology for dividing them between market dominant and competitive products. A soft floor for workshare discounts would only affect select prices for market dominant products; it would have no effect on competitive product costs or prices.

F. The Commission Can and Should Exercise Its Authority to Establish by Regulation a Soft Floor on Workshare Discounts

The Commission has acknowledged that the existing workshare regulations are not achieving the statutory objectives and factors, but it has also recognized that the PAEA only imposes a ceiling on workshare discounts. The Commission has previously stated:

Although the Commission concurs that the Postal Service should set its workshare discounts at avoided costs, it is not unlawful to set discounts below avoided costs.

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The worksharing requirements of Title 39 impose a ceiling but not a floor on passthroughs. See 39 U.S.C. § 3622(e)(2). The Commission notes that passthroughs below 100 percent send inefficient price signals to mailers. Therefore, it encourages the Postal Service to adjust discounts to bring passthroughs closer to 100 percent.<sup>50</sup>

The question of the Commission's authority to require *by regulation* a soft floor on workshare discounts was deemed beyond the scope of previous annual compliance determinations and rate adjustment proceedings. This proceeding is different. The 10-year review is an appropriate venue for the Commission to exercise its authority to require by regulation a soft floor on workshare discounts.

The statement that it is not “unlawful to set discounts below avoided costs” and the observation that the statute imposes “a ceiling but not a floor” highlight the need for the Commission to establish *by regulation* a soft floor on workshare discounts; especially where, as here, the Commission has acknowledged that the absence of such a requirement is inconsistent with the statutory objectives.<sup>51</sup>

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<sup>50</sup> Docket No. ACR2014, Annual Compliance Determination (Mar. 27, 2015) at 70, 76-77.

<sup>51</sup> *Id.*

The Commission has the authority to establish and, as necessary, revise by regulation the “modern system of regulating rates.”<sup>52</sup> Moreover, the Commission is required to review the modern rate system, including the existing workshare regulations, to determine whether the system it established is achieving the statutory objectives, taking into account the statutory factors, established by Congress.<sup>53</sup> If the Commission determines that the system it established is not achieving the statutory objectives then the Commission may by regulation make modifications or adopt an alternative system as necessary to achieve the objectives.<sup>54</sup> In doing so the Commission may require, by regulation a soft floor on workshare discounts. Once issued through notice and comment rulemaking, those regulations would legally bind the Postal Service. *See Batterton v. Francis*, 432 U.S. 416, 425 (1977)(regulation adopted pursuant to delegated authority after notice and comment rulemaking has “legislative effect”).

Numerous parties have filed comments on the question of whether the statutory requirements are subject to potential modification or replacement in this proceeding. The Commission’s authority to establish by regulation a soft floor on workshare discounts is not dependent on the resolution of that issue. The Commission can establish by regulation a soft floor on workshare discounts without the modification or replacement of section 3622(e)(2) or any other statutory requirement. To the extent the Commission holds that it has the authority under section 3622(d)(3) to modify statutory requirements, it can use that authority to require by regulation a soft floor on workshare discounts. To the extent the Commission holds that the statutory requirements are mandatory features of the modern rate system, it has the authority to require by regulation a soft floor on workshare discounts under section 3622(a) or section 3622(d)(3), because no modification or replacement of a statutory requirement is needed for this

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<sup>52</sup> 39 U.S.C. 3622(a).

<sup>53</sup> *See* 39 U.S.C. 3622(d)(3).

<sup>54</sup> *See id.*

change, and because the workshare regulations were established by the Commission as part of “the system for regulating rates and classes for market-dominant products” that is subject to mandatory review under section 3622(d)(3).

Section 3622(e)(2) states that “[t]he Postal Regulatory Commission shall ensure that such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity,” unless specified exceptions are met. 39 U.S.C. § 3622(e)(2). As the Commission has noted, the statute sets a ceiling for workshare discounts, it is silent with respect to a floor. Thus, nothing in the statute forecloses the Commission from establishing by regulation a soft floor on workshare discounts.

Under settled principles of administrative law the Commission may establish such a regulation unless the statute “unambiguously forecloses” it. *See, e.g., Northeast Hosp. Corp. v. Sebelius*, 657 F.3d 1, 4 (D.C. Cir. 2011) (quoting *Nat’l Cable & Telecomm. Ass’n v. FCC*, 567 F.3d 659, 663 (D.C. Cir. 2009) (deferring to an agency construction that was not “unambiguously foreclose[d]” by the statute)). *Accord, National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967, 980-83 (2005) (agency’s course of action permissible unless the “statute unambiguously forecloses” it). As the Commission has previously recognized, the PAEA does not unambiguously foreclose such a rule. *See* Docket No. ACR2007, Annual Compliance Determination (Mar. 27, 2008) at 97 (“the requirements of the PAEA do not directly address workshare discounts that are below 100 percent of avoidable costs”).

The Commission is granted substantial authority to develop such rules provided that the rule is “based on a permissible construction of the statute.” *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984); *Barnhart v. Walton*, 535 U. S.

212, 217-218 (2002). Indeed, if the “agency’s construction is reasonable, *Chevron* requires a federal court to accept the agency’s construction of the statute, even if the agency’s reading differs from what the court believes is the best statutory interpretation.” *Brand X*, 545 U.S. at 980. *Accord, Van Hollen v. FEC*, 811 F.3d 486, 492 (D.C. Cir. 2016)(noting the “wide latitude [courts] afford agencies when interpreting statutes: we do not demand the best interpretation, only a reasonable one.”) (emphasis in original); *see also UC Health v. NLRB*, 803 F.3d 669, 675 (D.C. Cir. 2015) (requiring deference if an agency construction is “reasonable and consistent with the statute’s purpose”); *Kennecott Utah Copper Corp. v. United States Dept. of Interior*, 88 F.3d 1191, 1206 (D.C. Cir. 1996) (*Chevron* step two requires affirmance of the agency if it considered the matter in a detailed and reasoned fashion and its interpretation is arguably consistent with the underlying statutory scheme).

A Commission decision to establish by regulation a soft floor on workshare discounts would be entitled to deference because Congress expressly delegated the authority to the Commission to establish regulations to implement the modern system of regulating market dominant products, because the soft floor would be promulgated in the exercise of that authority through notice and comment rulemaking, and because establishing a soft floor on workshare discounts promotes the specific statutory objectives established by Congress. *See United States v. Mead Corporation*, 533 U.S. 218, 226-29 (2001); *Yellow Transportation Incorporated v. Michigan*, 537 U.S. 36, 45 (2002).

Under section 3622(a) the Commission has the continuing authority to revise by regulation the modern rate system it established in 2007. Under section 3622(d)(3) the Commission is further given the authority to modify or adopt an alternative rate system if it finds the system it established, including the workshare regulations, is not achieving the statutory

objectives in section 3622(b), taking into account the statutory factors in section 3622(c).

Establishing by regulation a soft floor on workshare discounts is a permissible construction of the statute; in fact, it is the *only* interpretation that gives effect to Objectives 1 and 8 and Factors 5, 7, and 12 while balancing the other objectives and factors. The Commission can and should adopt by regulation a soft floor on workshare discounts.

### III. CONCLUSION

For all of the reasons stated above, establishing by regulation a soft floor on workshare discounts is a reasonable construction of the statute that best gives effect to multiple statutory objectives (Objectives 1 and 8) and factors (Factors 5, 7, and 12) without unduly conflicting with any others. The Commission has the authority to establish by regulation a soft floor on workshare discounts, it can and should do so as part of the 10 year review.

Respectfully submitted:

\_\_\_\_\_/s/\_\_\_\_\_  
James Pierce Myers  
Attorney at Law  
320 South West Street, Suite 110  
Alexandria, Virginia 22314  
Telephone: (703) 627-5112  
E-Mail: jpm@piercemyers.com

Michael F. Scanlon  
K&L GATES LLP  
1601 K Street, NW  
Washington, DC 20006  
Telephone: (202) 661-3764  
E-Mail: michael.scanlon@klgates.com

Counsel to PITNEY BOWES INC.

## Source Information for Tables 1-4

Table 1: Sources

- [1] Docket No. ACR2016, USPS-FY16-4, FY 2016 FCM.xlsx, "A-4 Automation Letters"
- [2] Docket No. ACR2015, USPS-FY15-4, FY15 FCM BDs\_Rev\_3-25-16.xlsx, "A-4 Automation Letters"
- [3] Docket No. ACR2014, USPS-FY14-4, FY 2014 FCM.xlsx, "A-4 Automation Letters"
- [4] Docket No. ACR2013, USPS-FY13-4, FY 2013 FCM.xls, "A-4 Automation Letters"
- [5] Docket No. ACR2012, USPS-FY12-4, FY 2012 FCM.xls, "A-4 Automation Letters"
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- [8] Docket No. ACR2009, USPS-FY09-4, FCM letter costs 2009.xlsx, "A-4 Automation Letters"
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Table 2: Sources

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"NP REG AUTO LETTERS P. G3-1"

Table 3: Sources

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  - [b] Docket No. ACR2015, PRC-ACR2015/3, 2015 FCM Results.xlsx, "FCM Worksharing"
  - [c] Docket No. ACR2014, PRC-ACR2014/3, FCM FY2014 Results.xlsx, "FY2014"
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